Johor Sino-Malay Timber Agency v Ketua Pengarah Hasil Dalam Negeri

HIGH COURT (KUALA LUMPUR) — TAX APPEAL NO R1–14–4 OF 1997
ABDUL KADIR SULAIMAN J
15 OCTOBER 1997

Revenue Law *— Income tax — Deduction — Whether payments constitute sums payable for the use of a licence or permit to extract timber — Appellant granted right to extract timber by two statutory authorities — Appellant to pay consideration for this right — Whether payments were expenses deductible under s 33(1) of the Income Tax Act 1967 — Whether both authorities were State Government owned — Income Tax Act 1967 ss 33(1) & 39(1)(g)*

The State Government of Johor ('the government') granted to Lembaga Kemajuan Johor Tenggara ('KEJORA') and the State Economic Development Corporation of Johor ('JSEDC') certain designated forest areas, the right to extract and fell timbers from therein. The two authorities entered into three agreements with the appellant, granting it the exclusive right to work out, fell, exploit and extract all timber found therein for certain consideration. The respondent did not regard these payments as out-goings and expenses in the production of the appellant's gross income from its source of business of buying and selling timber so as to allow the appellant to adjust its income under s 33 of the Income Tax Act 1967 ('the Act'). As a result of the disallowance of the aforesaid payments, timber profit tax was assessed on the appellant. The appellant disagreed and contended that the payments were for the purchase of standing timber and not for the use of a licence or permit granted to the two authorities to extract it and therefore, it was allowable as a deduction under s 33(1) of the Act being its revenue expenditure.

The appellant also contended that s 39(1)(g) of the Act did not apply because the licence or permit to extract the timber was actually given to it and the payments were not for the use of a licence or permit to extract timber. The appellant further argued that s 39(1)(g) of the Act was ambiguous to exclude the appellant from the benefit of s 31 in that it was unclear whether the payments to the statutory authorities could be deducted for income tax purposes since the State Government owned or controlled the two authorities exclusively.

The commissioners for income tax rejected the contentions of the appellant, holding that based on the agreements, the two authorities gave the appellant the right to work out, fell, exploit and extract all timber found in the designated areas and the appellant had acquired those rights and therefore, it could not be said that the payments made were for the purchase of standing timber. The payments, therefore, could not be revenue expenditure of the appellant but more akin to capital expenditure and s 33(1) of the Act would not operate in favour of the appellant. The appellant appealed against the decision of the commissioners.

Held, dismissing the appeal:

The three agreements which gave the appellant the exclusive rights to work out, fell, exploit and extract all timber found therein had resulted in the two authorities assigning their rights and liabilities over the areas given to them by the government to the appellant. As the exploitation of forest products requires a licence or permit, it followed that the assignment included the assignment of the licence or permit given to the authorities. The appellant, in order to get the benefit conferred on it by the agreements, must be using the licence or permit given to the original grantee — the two statutory bodies — to enable it to extract the timber from the designated areas. Therefore, whatever timber obtained from the areas for the appellant to sell in the manner of its trade could not be termed as the selling of its stock-in-trade to qualify as an expenditure allowable under s 33(1) of the Act. Using the licence or permit of the original grantee to extract timbers, the appellant would fall within the category of persons envisaged by s 39(1)(g) of the Act. If that be the case, the issue of whether the payments made by the appellant was capital or revenue expenditure would lose its sting as under s 39(1)(g), any sum, by whatever name called, payable to the two authorities for the use of their licence or permit to extract timber from a forest would not attract the provisions of s 33 at all to allow the appellant to adjust its income from the source.

There was also no evidence that the State Government owned or controlled the two authorities exclusively. KEJORA was a statutory body established under the Lembaga Kemajuan Johor Tenggara Act 1972 and JSEDC was a body corporate established under Enactment No 4 of 1968 of Johor. This could be seen from the preamble to the agreements. Whatever their position, they were not the State Government as qualified by s 39(1)(g) of the Act (see pp 655G–I and 656B–D, G).

[Bahasa Malaysia summary

Kerajaan Negeri Johor ('kerajaan tersebut') telah memberikan kawasan hutan tertentu, hak untuk mengekstrak dan menebang balak daripadanya kepada Lembaga Kemajuan Johor Tenggara ('KEJORA') dan Pertubuhan Pembangunan Ekonomi Negeri Johor ('PPENJ'). Kedua-dua pihak berkuasa itu telah mengikat tiga perjanjian dengan perayu, memberikannya hak eksklusif untuk merancang, menebang, mengguna dan mengekstrak semua balak yang didapati dalamnya untuk balasan tertentu. Penentang tidak menganggap bayaran ini sebagai wang keluar dan belanja dalam pengeluaran pendapat kasar perayu daripada sumber perniagaannya menjual dan membeli balak supaya membenarkan perayu menyelaraskan pendapatannya di bawah s 33 Akta Cukai Pendapatan 1967 ('Akta tersebut'). Akibat bayaran tersebut yang tidak dibenarkan, cukai keuntungan balak dikenakan pada perayu. Perayu tidak bersetuju dan berhujah bahawa bayaran adalah untuk belian balak tetap dan bukan untuk penggunaan lesen

atau permit yang diberikan kepada dua pihak berkuasa itu untuk mengekstraknya dan maka, ia dibenarkan sebagai satu penolakan di bawah s 33(1) Akta tersebut yang merupakan perbelanjaan hasil. A

Perayu juga berhujah bahawa s 39(1)(g) Akta tersebut tidak terpakai kerana lesen atau permit untuk mengekstrak balak benar-benar diberikan kepadanya dan bayaran-bayaran bukanlah untuk kegunaan lesen atau permit untuk mengekstrak balak. Perayu seterusnya menghujahkan bahawa s 39(1)(g) Akta tersebut adalah taksa dalam mengecualikan daripada faedah s 31 dalam ertikata bahawa ia tidak jelas sama ada bayaran kepada pihak berkuasa statutori boleh ditolak untuk tujuan cukai pendapatan memandangkan Kerajaan Negeri memiliki atau menguasai dua pihak berkuasa itu secara eksklusif. B C

Pesuruhjaya cukai pendapatan telah menolak hujah perayu, dengan memutuskan bahawa berdasarkan perjanjian-perjanjian, dua pihak berkuasa itu telah memberikan perayu hak untuk merancang, menebang, mengguna dan mengekstrak segala balak yang didapati dalam kawasan yang dinamakan dan perayu telah memperolehi hak-hak itu dan dengan itu, tidak boleh dikatakan bahawa bayaran-bayaran dibuat untuk belian balak tetap. Maka, bayaran-bayaran itu tidak mungkinlah perbelanjaan hasil perayu tetapi lebih merupakan perbelanjaan modal dan s 33(1) Akta tersebut tidak akan beroperasi memihak kepada perayu. Perayu merayu terhadap keputusan pesuruhjaya. D E

Diputuskan, menolak rayuan:

Tiga perjanjian itu yang memberikan perayu hak eksklusif untuk merancang, menebang, mengguna dan mengekstrak semua balak yang dijumpai dalamnya telah menyebabkan dua pihak berkuasa itu menyerahhak hak dan tanggungan mereka atas kawasan yang diberikan kepada mereka oleh kerajaan tersebut kepada perayu. Oleh kerana eksploitasi keluaran hutan memerlukan lesen atau permit, ini bemakna bahawa penyerahhakan termasuk penyerahhakan lesen atau permit yang diberikan kepada pihak-pihak berkuasa. Bagi mendapatkan faedah yang dianugerahkan oleh perjanjian tersebut, perayu mestilah mengguna lesen atau permit yang diberikan kepada penerima pemberian asal — dua badan statutori itu — supaya membolehkannya mengekstrak balak daripada kawasan yang dinamakan. Maka, apa saja balak yang didapati daripada kawasan untuk perayu menjual dalam cara perniagaannya tidak boleh dikelaskan sebagai jualan sesuatu yang perlu agar layak sebagai perbelanjaan yang dibenarkan di bawah s 33(1) Akta tersebut. Dengan menggunakan lesen atau permit penerima pemberian yang asal untuk mengekstrak balak, perayu akan dirangkumi oleh kategori orang yang dibayangkan oleh s 39(1)(g) Akta tersebut. Jika demikian, isu tentang sama ada bayaran yang dibuat oleh perayu adalah perbelanjaan modal atau hasil hilang kekuatannya kerana di bawah s 39(1)(g), apa-apa jumlah, dipanggil apa jua nama, yang harus dibayar kepada dua pihak berkuasa itu untuk kegunaan lesen atau permit mereka bagi mengekstrak balak F G H I

dari hutan tidak akan melibatkan peruntukan s 33 sama sekali bagi membolehkan perayu menyelaraskan pendapatannya daripada sumber tersebut.

Tiada juga keterangan bahawa Kerajaan Negeri memiliki atau menguasai dua pihak berkuasa itu secara eksklusif. KEJORA adalah sebuah badan statutori yang diwujudkan di bawah Akta Lembaga Kemajuan Johor Tenggara 1972 dan PPENJ adalah badan korporat yang diwujudkan di bawah Enakmen No 4 tahun 1968 Johor. Ini boleh dilihat daripada mukadimah perjanjian-perjanjian. Biar apa pun kedudukan mereka, mereka bukanlah Kerajaan Negeri seperti yang disyaratkan oleh s 39(1)(g) Akta tersebut (lihat ms 655G–I dan 656B–D, G).]

Notes

For cases on deduction, see 10 *Mallal's Digest* (4th Ed, 1996 Reissue) paras 1796–1822.

Case referred to

Director General of Inland Revenue v Rakyat Berjaya Sdn Bhd [1984] 1 MLJ 248 (refd)

Legislation referred to

Income Tax Act 1967 ss 31, 33(1), 39(1)(g)
Lembaga Kemajuan Johor Tenggara Act 1972

Wong Kim Fatt (*Gan Huey Piin* with him) (*Gulam & Wong*) for the appellant.

Kok Keng Fai (Pegawai Undang-Undang, Lembaga Hasil Dalam Negeri) for the respondent.

Cur Adv Vult

Abdul Kadir Sulaiman J: This is an appeal by the appellant by way of case stated against the order of the special commissioners for income tax of 7 November 1977, dismissing its appeal against the decision of the respondent which disallowed deductions from its gross income for tax purposes, certain payments made to two statutory authorities for the right to extract timber in certain designated areas granted to the said authorities by the State Government of Johor.

The State Government of Johor ('the government') granted to Lembaga Kemajuan Johor Tenggara ('KEJORA') and the State Economic Development Corporation of Johor ('JSEDC') certain designated forest areas, the right to extract and fell timbers from therein. But they did not carry out the extraction and felling of the timber themselves. Instead, they entered into all three agreements with the appellant, granting it the exclusive right to work out, fell, exploit and extract all the timber found therein for certain consideration. Part of the consideration is the various payments the appellant made to the said authorities which is the subject matter of this appeal. The amount involved is as follows:

Year of Assessment	Amount paid (RM)
1975	182,806
1976	218,133
1977	320,017
1978	57,355

The respondent does not regard these payments as out-goings and expenses wholly and exclusively during that period by the appellant in the production of its gross income from its source of business of buying and selling timber so as to allow the appellant to adjust its income under s 33 of the Income Tax Act 1967 ('the Act'). As a result of the disallowance of the aforesaid payments, timber profit tax was assessed on the appellant for the years of assessment 1975 and 1977 as per the notices of assessment dated 26 May 1984 amounting to RM38,741 for the year of assessment 1975 and the sum of RM59,025.80 for the year of assessment 1977.

The appellant disagreed. Before the commissioners, the appellant contended that the said payments were for the purchase of standing timber and not for the use of a licence or permit granted to the two authorities to extract it. Therefore, it is allowable as a deduction under s 33(1) of the Act it being revenue expenditure. In the alternative, the appellant contended that s 39(1)(g) of the Act does not apply because the licence or permit to extract timber was actually given to it and the payments were not for the use of a licence or permit to extract timber. Section 39(1)(g) as it was applicable during the relevant period states:

> (1) Subject to any express provision of this Act, in ascertaining the adjusted income of any person from any source for the basis period for a year of assessment no deduction from the gross income from that source for that period shall be allowed in respect of —
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> (g) any sum, by whatever name called, payable (otherwise than to a State Government or with the approval of the Minister, a statutory authority, or other body the capital or fund of which is wholly or substantially owned by a State Government or a statutory authority) for the use of a licence or permit to extract timber from a forest in Malaysia.

The commissioners rejected both the contentions of the appellant, holding that based on the agreements, the two authorities gave the appellant the right to work out, fell, exploit and extract all timber found in the designated areas and the appellant had acquired those rights and therefore, it cannot be said that the payments made were for the purchase of standing timber. As for the licence or permit, it was given to the two authorities by the government and the appellant made use of it to work the areas. Hence, the payments come within the ambit of s 39(1)(g) of the Act. As the payments were not for the purchase of standing timber, they cannot be revenue expenditure of the appellant but more akin to capital expenditure. Hence, s 33(1) does not operate in favour of the appellant.

The question of law for the opinion of this court is whether on the facts found and stated by the commissioners, their decision is correct in law. The determination of this question depends on the interpretation of

A s 33(1) and the pre-amended s 39(1)(g) of the Act. For tax purposes, s 33(1) deals with deductions which are allowed and s 39(1)(g) refers to deductions which are not allowed.

Before dealing specifically with the matter, I would like to address the issue raised by learned counsel for the appellant in this appeal that the B case stated contains some misstatement of facts. They are these. Firstly, at p 2, the commissioners gave the figures for the years of assessment 1975 to 1978 as being the amount of tax payable by the appellant while in actual fact, the figures for the years in question were in respect of the amount disallowed by the respondent as deductions for tax purposes. Following that, at p 11 of the case stated, the commissioners regarded the amount as C being the amount of tax assessed by the respondent and in dismissing the appeal, affirmed the assessment of the respondent, quoting the amount as being the tax assessed. Secondly, at p 5, the commissioners stated that the appellant did not submit any case authorities before them but listed the authorities purportedly referred to by the respondent. But in actual fact, it D was the other way round. This misstatement, according to the appellant, has affected the decision of the commissioners. Learned counsel for the respondent agrees that there were errors appearing in the case stated. He further pointed to another error found at p 3 in para 5(iii) where the 'appellant's bundle of documents — 'C' ' should have been 'appellant's bundle of authorities — 'C' '. Having considered the matter, while it is E expected that the commissioners in stating the case for the High Court would not make such errors, the errors so found to my mind will not in any way affect the decision made by the commissioners on the issue of liability to tax as regards the payments made by the appellant to the two authorities concerned in the exercise of its right over the exploitation of timber from F the designated areas.

Moving now to the issue in the appeal. The appellant's business is that of buying and selling timber. But on the facts as found by the commissioners, it is not a straightforward case of the appellant buying timber from the two authorities who had been granted the right by the government to extract and fell all timber found in the designated areas, as G part of its stock-in-trade. By the three agreements entered by the appellant, it was given the exclusive rights to work out, fell, exploit and extract all timber found therein. To my mind, the said agreements by their terms has resulted in the said two authorities assigning their rights and liabilities over the areas given to them by the government to the appellant. As the subject H matter was forest products, the exploitation of it requires a licence or permit, it necessarily follows that the said assignment includes the assignment of the licence or permit given to the authorities. This is evidenced by a common clause found in each of the three agreements that the appellant shall work the area in an orderly skilful and workmanlike manner and subject to the regulations and rules imposed under the Forest I Act, Ordinance or Enactment for the time being in force and with the terms and conditions of the licence or permit issued to the licence or permit holder and shall be liable to fully indemnify the statutory bodies for any expense which they may incur whether as fines inflicted on them or

otherwise on account of any breach of the provisions in the said clause by the appellant. Before the commissioners, no evidence was made available that the appellant was given exclusive licence or permit to work the areas. Therefore, the appellant, in order to get the benefit conferred on it by the said agreements, must be using the licence or permit given to the original grantee, the two statutory bodies, to enable it to extract the timber from the designated areas. Therefore, whatever timber obtained from the areas for the appellant to sell in the manner of its trade cannot be termed as the selling of its stock-in-trade to qualify as an expenditure allowable under s 33(1) of the Act. Using the licence or permit of the original grantee to extract timbers, the appellant would fall within the category of persons envisaged by s 39(1)(g) of the Act. If that be the case, the issue of whether the payments made by the appellant is capital or revenue expenditure loses its sting as under s 39(1)(g), any sum, by whatever name called, payable to the two authorities for the use of their licence or permit to extract timber from a forest would not attract the provisions of s 33 at all to allow the appellant to adjust its income from the source. But learned counsel for the appellant submitted that the licence was in substance granted to the appellant and not to the two statutory authorities. That argument cannot be accepted because there is no evidence that the government conferred the licence to the appellant. But the appellant was authorized to exploit timber pursuant to the three agreements which, by their operation, the statutory authorities had assigned their rights and liabilities to the appellant which would mean that the activity of the appellant was carried out with the use of the licence or permit given to the statutory authorities and in return for that, money considerations were provided by the appellant. Then counsel argued that s 39(1)(g) is ambiguous to exclude the appellant from the benefit of s 31. He submitted that the provision is unclear as to whether the payments to the statutory authorities could be deducted for income tax purposes since the State Government owns or controls exclusively the two authorities. But there is no evidence to that effect. KEJORA is a statutory body established under the Lembaga Kemajuan Johor Tenggara Act 1972 and JSEDC is a body corporate established under Enactment No 4 of 1968 of Johor. This can be seen from the preamble to the agreements. Whatever their position, they are not the State Government as qualified by the said s 39(1)(g) of the Act.

A B C D E F G H I

In *Director General of Inland Revenue v Rakyat Berjaya Sdn Bhd* [1984] 1 MLJ 248, the issue of s 39(1)(g) of the Act cropped up. Though it was in respect of that section as amended by Act A451/79 which came into force on 1 January 1980, the said amendment does not change the substance of the section except to enlarge the exclusion group contained in the bracket to include, with the approval of the Minister, a statutory authority, or other body the capital or fund of which is wholly or substantially owned by a State Government or a statutory authority. At p 254, Lee Hun Hoe CJ (Borneo), delivering the judgment of the then Federal Court said:

> Section 39(1)(g) is a unique provision under our Income Tax Act. We are not aware of any similar provision in the Commonwealth or elsewhere. This provision was specifically enacted to curtail unhealthy activity in the timber

A logging industry whereby a person is given a timber concession and he in turn gives away his rights under the concession to a third party for certain payment. The policy was to disallow the payment by the third party as a deduction in computing income of the third party. The provision was to implement that policy. It does not matter whether the payment is of a capital or income nature but as long as the payment is made for such right B then the payment should be disallowed under that provision.

Therefore, there is no ambiguity whatsoever in the purport of s 39(1)(g) of the Act. The appellant is the third party in relation to what was said by his Lordship in the above case. In this case, the statutory authorities gave away their rights under the concession to the appellant for certain payment.

C In the circumstances, for all the reasons given above, on the case stated, the commissioners were correct in their decision to dismiss the appeal of the appellant and to confirm the assessment made by the respondent in respect of the particular amount paid by the appellant to KEJORA and JSEDC. As regard to the confusion on the part of the D commissioners in relation to the amount of tax assessed by the respondent mentioned in the case stated, it is to be amended accordingly.

Appeal dismissed with costs to the respondent.

Appeal dismissed.

E Reported by David Lai

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